INDEPENDENT COMMUNITY
BANKERS of AMERICA

December 24, 2009

Jennifer J. Johnson, Secretary
Board of Governors of the
Federal Reserve System
20th Street & Constitution Avenue, NW
Washington, DC 20551
Attention: Docket No. R-1366

Re: Proposed Rule Amending Regulation Z as Part of a Comprehensive Review of the Truth in Lending Act's Rules for Closed-End Credit Secured by Real Property

Dear Ms. Johnson:

The Independent Community Bankers of America (ICBA)[1] appreciates the opportunity to comment on this proposed rule to amend Regulation Z as part of a comprehensive review of the Truth in Lending Act's (TILA's) rules for closed-end credit secured by real property. ICBA commends the Federal Reserve for their extensive consumer testing in revising these proposed rules and proposed mortgage disclosures. However, ICBA has several concerns with these provisions and urges the Federal Reserve to consider our comments when drafting any final amendments to Regulation Z.

[1] *The Independent Community Bankers of America represents nearly 5,000 community banks of all sizes and charter types throughout the United States and is dedicated exclusively to representing the interests of the community banking industry and the communities and customers we serve. ICBA aggregates the power of its members to provide a voice for community banking interests in Washington, resources to enhance community bank education and marketability, and profitability options to help community banks compete in an ever-changing marketplace.*

With nearly 5,000 members, representing more than 20,000 locations nationwide and employing nearly 300,000 Americans, ICBA members hold $1 trillion in assets, $800 billion in deposits, and $700 billion in loans to consumers, small businesses and the agricultural community. For more information, visit ICBA's website at www.icba.org.

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Summary of Comments

ICBA's comments included in this letter can be summarized as follows:

- Finalization of the Regulation Z proposed rules regarding mortgage loans should be delayed until the regulatory changes by the Department of Housing and Urban Development (HUD) outlined in the Real Estate Settlement Procedures Act (RESPA) can be in effect for several months and any problems or issues with these amendments can be examined. Finalization of the proposed rules should also be delayed pending additional congressional action regarding mortgage lending.

- The Federal Reserve should consider the resources of community banks when crafting additional regulatory requirements, so that the costs and burdens of further regulation will not drive community banks out of the mortgage market.

- The Federal Reserve should conduct extensive industry outreach, particularly to community banks around the country, before finalization of any proposed rules regarding mortgage lending.

- Any mandatory compliance deadline with final regulatory amendments should be at least 18 months following publication of the final amendments.

- ICBA recommends several edits to the "Key Questions to Ask about Your Mortgage" document which would provide further clarity regarding closed-end mortgage products.

- In regard to the proposed disclosures that must be provided within three days after application, ICBA opposes the requirement that creditors provide a graph that would show an APR for borrowers with excellent credit and an APR for borrowers with lower credit scores. In addition, ICBA has several edits to the H-19 model disclosure forms that would add greater clarity to the disclosures.

- ICBA strongly opposes the amended finance charge calculation requirements and urges the Federal Reserve to maintain the current APR calculation for closed-end loans, which will make these APRs comparable to HELOCs and other loan products.

- ICBA recommends the Federal Reserve allow consumers to opt out of waiting three business days after receiving final TILA disclosures before consummation of their loan transaction.

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- ICBA opposes a requirement that advance notice of a change to a variable interest rate be provided at least 60 days before payment at the new level is due, and instead recommends that this advance notice requirement be at least 30 days before payment at the new level is due.

- ICBA opposes any ban on yield spread premiums, as this compensation model has been in effect for decades by community banks that have no history of irresponsible lending activities. ICBA also opposes the proposed rule regarding "steering" because it is too vague and could cause unintended consequences for consumers.

- ICBA does not agree that it is necessary for consumers to receive additional disclosures regarding closed-end transactions that are secured by real property or a dwelling that are not principal dwellings.

- ICBA strongly urges the Federal Reserve to amend the provisions in Regulation Z regarding higher-priced mortgage loans that state there is no presumption of compliance for balloon loans with under seven year terms. ICBA also urges the Federal Reserve to amend the escrow requirements for higher-priced mortgage loans and exempt community banks that hold their loans in portfolio from these requirements.

Finalization of Regulation Z Proposed Rule Should be Delayed

While ICBA commends the Federal Reserve for their efforts in addressing problems in the current mortgage marketplace and their attempts at producing clear disclosures based on evidence from consumer testing, we strongly urge the Federal Reserve to delay finalizing this proposed rule until the regulatory changes by HUD outlined in RESPA (scheduled to take effect on January 1) can be in effect for several months and any problems or issues with these amendments can be examined. This approach is more practical and will allow both HUD and the Federal Reserve to review any outstanding issues before implementing further regulatory changes.

In addition, further regulatory changes on mortgages should be delayed pending any additional congressional action regarding mortgage lending. Because banks will be required to make massive operational changes to comply with these proposed extensive requirements, it would cause great burden if community banks were put in a position of making massive systems changes to comply with the proposed rules, and then later being required to revamp their systems to comply with future statutory requirements. This was the reality for community banks when the Federal Reserve published final regulatory amendments regarding open-end credit card disclosures last December, only to have most of these regulatory amendments become outdated after Congress passed the Credit Card Accountability, Responsibility and Disclosure Act of 2009.

Community banks have been put in a burdensome position with the conflicting credit card laws and regulations, and it would be detrimental to their business operations to have this same compliance burden for mortgage lending.

The Business of Community Banks

In regard to this particular proposed rule, ICBA understands the purpose in revising Regulation Z to address closed end mortgage loans and appreciates the Federal Reserve's efforts in incorporating consumer testing in producing model forms that can be used for these loans. ICBA also understands the Federal Reserve's motivation in changing many Regulation Z provisions to address issues presented in the recent mortgage crisis, and its eagerness to further regulate financial institutions that engaged in irresponsible lending practices that led to our current economic state. Nevertheless, when drafting final amendments to Regulation Z, ICBA urges the Federal Reserve to consider the fact that community banks have always engaged in responsible mortgage lending practices due to their vested interest in their communities and the consumers they serve.

Furthermore, most community bank mortgage loans are held in portfolio and not sold on the secondary market; therefore the underwriting for these loans has historically been more conservative since the banks have a vested interest in how the loans perform. Community banks also take great time to educate and inform their customers about the consequences of their borrowing decisions because of the banks' vested interest in the performance of these loans and the more familiar relationship with their customers.

ICBA strongly urges the Federal Reserve to consider these differences between community banks and large national financial institutions when crafting final rules, and to not punish community banks with harsh regulatory changes that will restrict their ability to lend to the consumers in their communities thereby making these consumers more dependent on the larger financial institutions that care more about profits than the financial health of the communities they serve. The reality is, the more regulatory changes that are forced onto smaller banks, the harder it will be for these banks to compete and offer loan products. Most community banks are understaffed and overworked as it is and the compliance resources of smaller more responsible financial institutions must be considered when crafting additional regulatory requirements.

Community Bank Outreach in Developing Regulatory Amendments

In the proposed rule, the Federal Reserve states that many of the regulatory changes are based on consumer testing. The Federal Reserve also states it solicited input on various issues from members of the Board's Consumer Advisory Council – which had one representative from a community bank - and met or conducted conference calls with various industry and consumer group representatives throughout the review process. Federal Reserve staff also reviewed disclosures currently provided by various creditors. In addition, the Federal Reserve states that in considering the proposed revisions, it sought to ensure the proposal would not reduce access to credit, and sought to balance the potential benefits for consumers with the compliance burdens imposed on creditors.

While ICBA is pleased the Federal Reserve conducted consumer testing and some industry outreach in developing these revised disclosures and additional regulatory requirements, we are concerned there was not enough industry outreach conducted to community banks when these disclosures and rules were being created, which is crucial in determining a proper balance between the potential benefit of regulatory changes for consumers with the compliance burdens for banks.

ICBA urges the Federal Reserve to continue industry outreach efforts when drafting the final rules for closed-end mortgage loan provisions and disclosures, particularly with community banks, which constitute 97% of all banks in the United States. In particular, given the large impact these rules would have on community banks, ICBA strongly encourages the Federal Reserve to conduct industry outreach meetings throughout the country and engage financial institutions of all sizes in discussions about the impact these regulatory changes will have on their mortgage business.

While ICBA understands the need to provide consumers with greater protections and more transparent disclosures, we have serious concerns that dramatic regulatory changes, if finalized without a thorough knowledge of community bank business practices, will result in too much regulatory burden for community banks and will consequently force many of these banks to exit the mortgage business. The lack of community bank representation in the mortgage marketplace will only affect consumers in a negative way, especially consumers in rural communities who have little access to larger national banks and who rely on their local community bank for all of their lending and banking needs.

Furthermore, ICBA would be open to meeting with Federal Reserve staff to discuss our comments in more detail, or alternatively, to organizing a meeting in Washington with community bankers and Federal Reserve staff so that our members can share their specific experiences regarding mortgage lending in their communities and the potential operational and compliance costs of these proposed regulatory changes.

<u>Deadline for Compliance with Final Rules</u>

The Federal Reserve states it contemplates providing creditors sufficient time to implement any revisions that may be adopted, and asks for comment on an appropriate implementation period.

ICBA Comments:

ICBA strongly recommends that any final rules amending Regulation Z to address closed-end mortgage loans require a compliance deadline of no sooner than 18 months following the publication of the final rule. Any changes to the forms and processing of mortgage loans will require significant systems modifications and compliance costs, and community banks especially will need as much time as possible to comply with these changes. This is especially the reality given the increase in regulatory changes in the past year (e.g., Regulation E, SAFE Act, Regulation Z credit card and student loan amendments, RESPA amendments) and the fact that community banks do not have the compliance resources that larger financial institutions have. Allowing at least 18 months will enable community banks to effectively comply with any changes. The Federal Reserve understood the need for providing an appropriate amount of compliance time when it published amendments to Regulation Z regarding credit cards with a compliance deadline of over 18 months after the regulatory changes were published. We urge the Federal Reserve to apply this same standard when finalizing rules regarding closed-end mortgage loans.

<u>Disclosures At Application</u>

Currently, Regulation Z requires pre-application disclosures only for variable-rate transactions. For these transactions, creditors are required to provide the CHARM booklet and a loan program disclosure that provides twelve items of information at the time an application is provided or before the consumer pays a nonrefundable fee, whichever is earlier.

To address the larger variety of mortgage loans that are provided today, the proposed rule would require creditors to give consumers a one-page Federal Reserve publication entitled, "Key Questions to Ask about Your Mortgage." Creditors would be required to provide this document for all closed-end loans secured by real property or a dwelling, not just variable rate loans, before the consumer applies for a loan or pays a nonrefundable fee, whichever is earlier.

ICBA Comments:

ICBA has several edits to this "Key Questions" document which include the following:

- <u>Question 1</u> – For the question, "Can my interest rate increase," the language in the answer states that "If you have an adjustable rate mortgage (ARM), your interest rate can go up or down after a short period. This means your monthly payments could increase." This language should be edited to state "If you have an adjustable rate mortgage (ARM), your interest rate may go up or down. This means that your monthly payments could increase or decrease."

ICBA recommends these edits to the answer because it may not be accurate that the interest rate can go up or down "after a short period." Some rates may be fixed for many years before they adjust. In addition, while we acknowledge that interest rates can adjust higher for ARMs, they can just as likely adjust lower, which could benefit the consumer in the long term. Therefore, the answer should not highlight that interest rates may increase unless it also mentions that they could decrease.

- Question 2 – The answer to this question which asks, "Can my monthly payment increase," states that payment may increase because "your property taxes or insurance premiums increase." The consumer's property taxes or insurance premiums may increase regardless of what mortgage loan the consumer chooses or regardless of whether they even have a mortgage loan. Since these questions are regarding mortgage loans, ICBA suggests deleting this reference to property taxes and insurance premiums. Alternatively, the Federal Reserve could delete the reference to property taxes and insurance in the second sentence of the answer, but add a third sentence to the answer which states, "In addition, your payments for property taxes or insurance premiums could increase."

- Question 3 – For the question, "Will my monthly payments reduce my loan balance," the answer only addresses interest-only mortgage loans but does not address the vast majority of mortgage loans where the monthly payments do pay down the loan principal amount. If the answer to this question is only designed to address interest-only loans, then the question should be phrased differently so as not to confuse the consumer. Or, alternatively, a sentence or two should be added to explain how monthly payments on more traditional mortgages may amortize the loan amount.

- Question 4 – This question focuses on mortgage products that allow the consumer to choose to pay even less than the interest owed on the loan each month, so that the unpaid interest is added to the loan balance and can increase the total amount of the loan that is owed. While these loans may have been more common a couple of years ago, they are currently an uncommon loan option given today's current market conditions.

  ICBA recommends the Federal Reserve examine the current prevalence of these particular loan products to ascertain whether this question may be dated and no longer applicable for today's consumers. Given the abundance of loan disclosures that consumers are receiving, ICBA only favors adding disclosures and information if they are useful to consumers and timely. Superfluous and outdated information only detracts from the more significant information.

- Question 5 – For this question which asks, "Could I owe a prepayment penalty," ICBA recommends deleting the word "large" from the first sentence, which states "Some loans charge you a large fee if you pay off your loan, refinance it, or sell your home within the first few years of the loan." Since some prepayment penalties are lower and in the hundreds of dollar range, the word "large" may overstate the fees that could be charged. Furthermore, the second sentence in the answer, which states "This penalty fee could be thousands of dollars," appropriately communicates to the consumer that these fees could be larger amounts.

- Question 6 – For this question which asks, "Will I have to document my employment, income, and assets to get this loan," ICBA recommends that the answer instead state (addition is underlined), "Sometimes a lender will make a loan without requiring you to show that you are employed and have the income or assets to repay the loan. These no-documentation ("no-doc") or low-documentation ("low-doc") loans usually have higher interest rates or higher fees than other loans, <u>or may be subject to greater interest rate fluctuation within a short period of time</u>." ICBA recommends that this underlined statement be added to this question to emphasize that these loans may be more volatile and that while initial interest rates on the loan may be reasonable, the interest rates could later increase to much higher amounts.

<u>Disclosures Provided Within Three Days After Application</u>

TILA and Regulation Z currently require creditors to provide an early TILA disclosure within three business days after application and at least seven business days before consummation, and before the consumer has paid a fee other than a fee for obtaining the consumer's credit history. If the APR on the early TILA disclosure exceeds a certain tolerance before consummation, the creditor must provide corrected disclosures that the consumer must receive at least three days before consummation. If a term other than the APR becomes inaccurate, the creditor must give the corrected disclosure no later than at consummation.

The early TILA disclosure, and any corrected disclosure, must include certain loan information including the amount financed, the finance charge, the APR, the total of payments, and the amount and timing of payments. The finance charge is the sum of all credit-related charges, excluding a variety of fees and charges. TILA requires the finance charge and the APR be disclosed more conspicuously than other information.

ICBA Comments:

ICBA recommends the Federal Reserve reexamine the requirement that creditors provide a graph with these TILA disclosures that would detail the APR for borrowers with excellent credit and the APR for borrowers with lower credit scores. This requirement would be costly and burdensome for community banks and would provide little benefit to consumers that are already overwhelmed with loan disclosures. In addition, this requirement assumes that a consumer's credit score is the only indicator in determining what their APR may be, when there are other factors outside of the consumer's control that can determine their APR. These factors include whether a consumer's home is in a rural area that doesn't qualify for sale on the secondary market, whether a consumer's home is in a declining market so the lender increases the interest rate because Fannie Mae and Freddie Mac standards determine that the loan is riskier, or whether a consumer is unable to apply a large down payment to their mortgage loan.

In addition, ICBA has concerns with the content of the model forms provided in section H-19. First, in the section that describes the APR, there is a question which states "How does this loan compare". The answer to the question provides examples of interest rates for applicants with "excellent credit" and "poor credit history." ICBA recommends the Federal Reserve use a different terminology rather than "poor credit history" in these model forms, such as "a lower credit score." In addition, this example can be misleading on these model forms because it can lead the consumer to assume their credit score is the only factor that will determine their interest rate, when as explained above, there can be several factors that determine this rate. Accordingly, ICBA does not agree that this example provides any use or benefit for the consumer as it is currently drafted.

Calculation of the Finance Charge

For closed-end loans secured by a borrower's principal dwelling, the Federal Reserve is proposing to include in the APR a number of mortgage fees that currently are excluded from the APR and are also excluded from the definition of "finance charge." These costs will include charges payable directly or indirectly by the borrower that are imposed as a condition to the extension of credit. The APR and finance charge will also include charges by third parties if the lender requires the use of a third party as part of the loan process, even if the borrower chooses the third party service provider or if the lender retains a portion of the third party charge to the extent of the portion retained.

The finance charge would continue to exclude fees or charges paid in comparable cash transactions. Other exclusions from the finance charge for closed-end credit transactions secured by real property would be limited to late fees and default or delinquency charges, seller's points and premiums for property and liability insurance. As new services are added and new fees are charged in connection with closed-end credit secured by real property, creditors would be required to apply a basic test in making judgments about whether or not new fees must be included in the finance charge.

This basic test, as proposed by the Federal Reserve, is a fee or charge is included in the finance charge for closed-end credit transactions secured by real property or a dwelling if it is (1) payable directly or indirectly by the consumer to whom credit is extended, and (2) imposed directly or indirectly by the creditor as an incident to or a condition of the extension of credit. The Federal Reserve states that their intent is to make the APR a more meaningful disclosure of the cost of credit.

ICBA Comments:

While ICBA supports the Federal Reserve's intent to provide consumers with more meaningful disclosures, we strongly oppose this change to the finance charge provisions because there will be several unintended consequences. First, the result of these changes would be that more loans may exceed the high-cost and higher-priced mortgage loan thresholds within §§ 226.32 and 226.35, which will subject these loans to additional disclosure requirements and restrictions. To the extent that state laws apply or may be amended to apply similar thresholds for high-cost or higher-priced mortgage loans, more loans could hit state thresholds as well, imposing additional requirements. As it is, due to the current abnormally low interest rate environment, most mortgage loans are considered "higher-priced," which require the additional Regulation Z requirements that became effective on October 1, 2009.

As ICBA has communicated to the Federal Reserve in the past, the mortgage provisions that became effective on October 1, 2009 have proved to be very burdensome to community banks, which have consistently provided healthy mortgage products to their customers. By further inflating the finance charge and APR figures, all mortgage loans will become higher-priced and will be subject to the additional requirements. Such a change will make it more justifiable for community banks to abandon the mortgage market and cease making these loans because they are no longer financially viable for the bank. The consequence of this business decision will be that consumers will have fewer lending options, and the mortgage lending market will be dominated by the few large financial institutions that can absorb the costs of these changes. For consumers in rural communities, where community banks may be the only accessible lenders, this change in the marketplace would be detrimental.

Second, if almost every cost and fee is included in the APR calculation for closed-end mortgage loans, then the consumer will think the real costs of the credit are much higher than they truly are, since the disclosed APR for the first year of the mortgage (when closing costs are paid) is artificially higher than the APR for the remaining years of the loan. There is much to be said about the rate driving the consumer market. For example, 4.75% APR with closing costs of $4000 sounds less expensive than 5.125% APR.

Thirdly, there are some fees that are based on the principal amount of the loan and others that are determined by the specific loan (i.e., filing fees are determined by the number of pages of the documents filed which can vary depending on the number of borrowers, the appearance clause length, the legal description of the property, and the font on the documents). Because many settlement costs and fees are set regardless of the principal loan amount, including such costs in the finance charge will overly inflate the APR for lower dollar mortgage loans which are frequently provided by community banks, especially banks located in rural communities where the property values are lower. This is yet another example of a regulatory change that puts community banks at a disadvantage.

Furthermore, it is often difficult to know the exact costs of certain fees far in advance so that these fees can be communicated to the consumer in an APR calculation early on in the process. For example, title insurance and attorney fees are not set by the banks and can be difficult to know far in advance to compute the APR figure. Failure to disclose the APR within the minimal accepted tolerance will force issuance of a new disclosure and can further delay the closing for consumers, especially if the Federal Reserve's proposed pre-consummation disclosure provisions are finalized.

In addition, imposing different requirements for closed-end mortgage loans and home equity lines of credit (HELOCs) does not make any sense if the intent is to provide more meaningful disclosures for consumers. Why would this all-inclusive APR disclosure be meaningful for a customer receiving a closed-end mortgage loan but not a customer receiving a HELOC? The Federal Reserve indicated that this all inclusive disclosure would not be necessary for HELOCs but would be necessary for closed-end mortgage loans. Given that both loans are secured by real property, the Federal Reserve should further explain their rationale for why an all-inclusive APR would not be necessary for HELOCs but is an effective disclosure for closed-end mortgage loans.

From a banker perspective, having different APR calculations for these different mortgage loan products would be overwhelmingly difficult, considering that community banks generally do not have different systems for calculating APRs for HELOCs and closed-end mortgage loans. Community banks that use third party compliance document preparation companies will be faced with greater costs given the changes that would need to be made.

Also, larger financial institutions may have the closed-end and open-end mortgage businesses within separate divisions of their institutions. The smaller community banks have limited staff resources and do not generally have this separation of duties, therefore making it harder for originating officers to differentiate between the different regulatory requirements, which can lead to greater chances of error or longer waiting periods for loan processing for consumers. Overall, such a distinction between the APR calculations for

HELOCs and closed-end loans will lead to extensive costs for staff training and massive and costly changes to processing systems, not to mention consumer confusion as to why APRs for closed-end loans include different fees and may be higher when compared to the APRs for HELOC loans. The costs and burdens associated with having two completely different APR calculations for home-secured loans may be too overwhelming for community banks and be yet another reason for these banks to abandon their mortgage business.

Finally, the test the Federal Reserve proposes to determine whether a fee is a finance charge does not provide enough specificity in determining what it and is not a finance charge and could subject financial institutions to legal and regulatory uncertainty. If the Federal Reserve decides to add additional costs and fees to the finance charge calculation, the regulation should be as clear as possible regarding which specific fees must be included and excluded, and not require individual banks to make this determination based on a legal test. Additional regulatory guidance in this area would be crucial.

Overall, ICBA urges the Federal Reserve to maintain the current APR calculation for closed-end loans, which will make them more comparable products to the HELOC loans. If there is a concern that consumers do not fully understand the various fees on their mortgage loans based on data found through consumer testing, then the Federal Reserve should propose rules to highlight these various fees on mortgage forms as a way to provide greater transparency for consumers. This would be a far better approach than requiring different APR calculations for different mortgage loans. Alternatively, if the Federal Reserve decides to apply the proposed changes to the APR disclosure for closed-end mortgage loans, ICBA urges it to reexamine and amend the current APR thresholds applicable to higher-priced and high-cost mortgage loans.

Disclosures Three Days Before Consummation

The creditor is required to provide early TILA disclosures to the consumer within three business days after receiving the consumer's written application and at least seven business days before consummation, and before the consumer has paid a fee other than a fee for obtaining the consumer's credit history. If the APR on the early TILA disclosure exceeds a certain tolerance before consummation, the creditor must provide corrected disclosures that the consumer must receive at least three days before consummation. If any term other than the APR becomes inaccurate, the creditor must give the corrected disclosure no later than at consummation. The consumer may waive the seven and three-day waiting periods for a bona fide personal financial emergency.

The proposal would require the creditor to provide a final TILA disclosure that the consumer must receive at least three business days before consummation, even if no terms have changed since the early TILA disclosure was provided. In addition, the Federal Reserve is proposing two alternative approaches to address changes to loan terms and settlement charges during the three-business-day waiting period.

Under the first approach, if any terms change during the three-business-day waiting period, the creditor would be required to provide another final TILA disclosure and wait an additional three business days before consummation could occur. Under the second approach, creditors would be required to provide another final TILA disclosure, but would have to wait an additional three business days before consummation only if the APR exceeds a designation tolerance or the creditor adds an adjustable rate feature. Otherwise, the creditor would be permitted to provide the new final TILA disclosure at consummation.

ICBA Comments:

ICBA understands the Federal Reserve's concern that some creditors may be surprising consumers with new fees and charges at loan closing; however we have many concerns with this additional three day requirement. Financial institutions are already required to provide the consumer with early TILA disclosures and good faith estimate disclosures within three days of loan application and whenever there is a change in the interest rate or loan amount. The additional burden of requiring that the packages be completed three additional days prior to closing will slow the closing process down with no net benefit to the consumer. Banks are already required to wait the regulated seven business days from application to close, three additional days for rights of rescission, and three days for the re-disclosure of the APR. The process has already been slowed down substantially, often at the detriment to the consumer.

Furthermore, ICBA has received comments from community banks indicating that sometimes the customer wants to watch interest rates very close to the closing time, or sometimes the appraisal comes in very late in the process and the loan amount needs to be adjusted. Also, sometimes the loan-to-value ratio determines what loan product or pricing the customer can receive on the secondary market, and if you have to adjust the interest rate or loan amount prompting the need for the three day redisclosure, the customers cannot make their closing dates, which can run them into late charges in the case of a refinance where they are paying off another lender. In the case of a purchase, there can be a huge domino affect where one sale has to happen before another one can, and so on. If the first transaction cannot close because of the need to redisclose loan terms, this can negatively affect the consumers on that transaction as well as on three or four other transactions.

To address some of the issues that may occur with loan closing as specified above, ICBA recommends the Federal Reserve provide consumers with the ability to opt out of waiting the three days if they so choose. This alternative requirement will still provide consumers the additional time with their disclosures,

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but will also expedite the process for those consumers that wish to close on their loans earlier.

With regard to the two alternatives proposed by the Federal Reserve for re-disclosure, ICBA prefers the second alternative which would require re-disclosure only if the final APR exceeds a certain minimum tolerance or if the creditor adds an adjustable rate feature. While ICBA has concerns with this three day disclosure requirement, unless a consumer opt-out can be provided, we definitely oppose any requirement for re-disclosure and an additional three day waiting period if any loan term changes. The delay imposed by such a requirement could cause even more disruption in the closing process, at the detriment to the consumer.

<u>Disclosures After Consummation</u>

Regulation Z requires certain notices to be provided after consummation. Currently, for variable-rate transactions, creditors are required to provide advance notice of an interest rate adjustment. There are no disclosure requirements for other post-consummation events. This notice of interest rate adjustment must be provided at least 25, but not more than 120, calendar days before a payment at a new level is due. Creditors must also provide an adjustment notice at least once each year during which an interest rate adjustment is implemented without an accompanying payment change.

Under the proposed rule, creditors would be required to provide the ARM adjustment notice at least 60 days before payment at a new level is due.

ICBA Comments:

ICBA opposes this 60-day requirement and instead recommends the Federal Reserve implement a 30-day requirement for these disclosures. An advance notice requirement of greater than 30 days will result in consumers having interest rate changes that are less reflective of the current market interest rates. Some community banks provide notices 30 days in advance, which means the interest rate is more than one month old; when banks must send the notice at least 60 days in advance, the interest rate will be at least two months old. This is a long period of time if interest rates are moving quickly.

For loans that are less than 1 year duration, ICBA supports any provisions that would require less advance notice for interest rate adjustments.

<u>Prohibitions on Payments to Loan Originators and Steering</u>

The Federal Reserve proposes to prohibit payments to loan originators that are based on the loan's terms and conditions. This prohibition would not apply to payments that consumers make directly to loan originators. If a consumer directly pays the loan originator, the proposal would prohibit the loan originator from also receiving compensation from any other party in connection with that transaction.

Under the proposal, a "loan originator" would include both mortgage brokers and employees of creditors who perform loan origination functions. The Federal Reserve also seeks comment on an optional proposal that would prohibit loan originators from directing or "steering" consumers to a particular creditor's loan products based on the fact that the loan originator will receive additional compensation even when that loan may not be in the consumer's best interest.

ICBA Comments:

First, the definition of "loan originator" should exclude individuals who are managers and supervisors, whose compensation is not contingent on the loans they directly originate but on the production of the individuals they manage and supervise. These individuals should be excluded from this definition as they have little impact on an individual loan.

Second, ICBA is opposed to any ban on yield spread premiums as this is how a community bank is able to make money on a loan. Community banks do not manipulate the interest rates that consumers receive to get greater compensation because the rates provided to consumers still must be competitive in the market. The yield spread premium is a way for a community bank to remain competitive in the marketplace and provide rates to their customers that are reflective of the current market trends and conditions. A ban on this compensation method would take this freedom away from community banks, which could negatively affect a consumer's ability to get a competitive rate.

Also, this compensation model has been in effect for decades and community banks have never participated in predatory or irresponsible lending practices that the Federal Reserve is trying to address with this possible provision. If the Federal Reserve wishes to address predatory lending, then those practices should be directly addressed. Further regulating lender compensation will instead punish the honest lenders that have never engaged in irresponsible lending practices.

In addition, ICBA is opposed to any requirements that compensation be based on loan principal, because such a requirement would not take into consideration the complexity, time, and expense required to set up certain loans. For example, you can have a small dollar loan that has many issues and consumer information that must be verified thereby requiring extensive preparation time and lender expense, and some lenders might not be interested in providing these loans because the compensation would be based on the small principal amount and the time spent preparing the loan would outweigh any compensation received. If lenders start to manage their business in this manner, consumers could have far fewer lending options available to them.

Furthermore, while we agree that loan originators should not direct or steer consumers to a particular loan product solely because they will receive additional compensation for sale of the product, ICBA has concerns with the Federal Reserve's anti-steering proposed rule. The proposed rule would define prohibited steering based on what is in the "consumer's interest." It would state there is no steering if the consumer selects a loan from "three loan options for each type of transaction in which the consumer expressed an interest," and the loan originated satisfies several other requirements, including a requirement to supply a number of options for loan types in which the consumer "expresses an interest" and for which the loan originator has a good faith belief that the consumer likely qualifies.

ICBA thinks compliance with this proposed rule would be quite burdensome, given the vagueness of the requirements. If the Federal Reserve chooses to address this issue, the provision should state there is a presumption of compliance for total compensation that is customary and reasonable. The goal should not be to prohibit a creditor from guiding a consumer through the lending process and presenting all of the options that might be available to them. This proposed rule could cause some lenders to be fearful of presenting certain options to consumers out of concern that they may appear to be steering a consumer toward or away from a certain loan product. This rule could inadvertently cause creditors to not fully advise potential borrowers of all the options they may qualify for, thereby wasting the expertise that creditors can provide to consumers.

<u>Loans Secured by Personal Property that is a Dwelling</u>

The Federal Reserve is proposing to extend the scope of Regulation Z to reach all closed-end credit transactions secured by real property or a dwelling, not just principal dwellings. The Federal Reserve recognizes that if personal property that is a dwelling but not the borrower's principal dwelling secures a loan of over $25,000, it is not covered by TILA in the first place. The Federal Reserve solicits comment on whether consumers in these transactions receive adequate information regarding their loan terms and are afforded sufficient protections.

ICBA Comments:

This proposed change would greatly increase a creditor's litigation risk and compliance burden, yet there has not been any evidence presented by the Federal Reserve as to why the change would be necessary. Because of the additional compliance costs associated with such a change, ICBA urges the Federal Reserve to examine whether this change is actually necessary and would be useful to consumers.

Final Amendments to Address Higher-Priced Mortgage Loans, Effective October 1, 2009

Finally, when crafting final amendments to the closed-end mortgage provisions, ICBA also urges the Federal Reserve to revisit the changes they made in their prior rulemaking to amend Regulation Z to address higher-priced mortgage loans, which became effective on October 1, 2009. ICBA has discussed with Federal Reserve staff the unintended consequences these rules have had on community banks – particularly the provisions which state there is no presumption of compliance for higher-priced balloon mortgage loans with less than seven year terms, and provisions to require escrow accounts for all higher-priced mortgage loans. To address some of ICBA's concerns, the Federal Reserve published an interpretation letter, CA 09-12, which clarified that higher-priced balloon loans with less than seven year terms can be provided to consumers as long as the borrower's ability to repay the balloon loan is verified. The Federal Reserve explained that a creditor may verify the borrower's ability to repay a short-term balloon loan by verifying the consumer's ability to make regular monthly payments (which does not include the final balloon payment), and the consumer's likelihood of being able to satisfy the balloon payment obligation by refinancing the loan or through income or assets other than the collateral.

While ICBA appreciates the Federal Reserve's clarification regarding banks' ability to provide these balloon payment loans, we are still very concerned that the regulatory language in § 226.34 states there is no presumption of compliance for higher priced balloon loans with less than seven year terms. The interpretative letter, CA 09-12, does not address the presumption of compliance issue. This is still a concern for community banks that continue to decline (and are being advised to decline) to make these balloon loans because of the compliance risks associated with higher-priced mortgage loans due to this regulatory language. Therefore, we strongly urge the Federal Reserve to amend the language in § 226.34 to exclude from this section higher-priced balloon mortgage loans that are held in portfolio by community banks. Because community banks have a vested interest in the performance of their loans held in portfolio, the banks will automatically engage in responsible underwriting to insure the strong performance of these loans. It is for this reason that community bank balloon mortgage loans have been an effective loan product for decades and have as low, or lower, default rates as traditional 30-year mortgage loans.

In addition, ICBA strongly urges the Federal Reserve to revisit the provisions regarding required escrow accounts for higher priced mortgage loans. This requirement will add tremendous operating costs for community banks that, in most cases, do not require escrows for loans they hold in portfolio due to the cost of establishing and maintaining an escrow service. Our membership generally consists of smaller banking institutions with limited staff, and many of our members have communicated to us that they will cease providing mortgages because the escrow operating expenses will be too great.

Community banks also have limited options for outside servicing of these escrow accounts because these banks often have a smaller mortgage loan volume, making them less attractive to outside loan servicers. In addition, many community banks are concerned about the risk that outside loan servicers will attempt to cross sell the customer other bank or financial services, to the detriment of the community bank.

ICBA believes that escrow accounts are not necessary if the loans are properly underwritten to ensure the borrower has the financial ability to pay the loan as well as the insurance and property tax payments. We urge the Federal Reserve to amend this escrow requirement to exempt mortgage loans that satisfy the financial institution's underwriting requirements and that are held in portfolio by the institution.

ICBA thanks you for the opportunity to comment on this proposed rule. As you are aware, community banks are common-sense lenders that offer mortgage products on fair terms as a means of providing valuable services to their customers. In drafting final amendments, please keep in mind that community banks care about customer service more than anything else, and have not engaged in the misleading practices conducted by some of the larger financial institutions that led us to our current economic crisis.

If you have any questions about this letter or need additional information, please do not hesitate to contact me at 202-659-8111 or Elizabeth.Eurgubian@icba.org. In addition, ICBA would be happy to meet with Federal Reserve staff to discuss these comments in further detail and provide additional insight from the community banker perspective.

Sincerely,

/s/

Elizabeth A. Eurgubian

Vice President & Regulatory Counsel